**Before the**
**Federal Communications Commission**
**Washington DC 20554**

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| In the Matter of | ) | |
| | ) | |
| Notice of Inquiry Concerning a Review of the | ) | |
| Equal Access and Nondiscrimination | ) | CC Docket No. 02-39 |
| Obligations Applicable to Local Exchange | ) | |
| Carriers | ) | |

# COMMENTS OF VERIZON


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The equal access and nondiscrimination obligations that were originally crafted more than twenty years ago no longer serve a useful purpose, are counterproductive, and should be eliminated.

In the two decades since these obligations were adopted, the communications marketplace has undergone fundamental transformations relating to how customers decide which carrier will transport their long distance calls. Following divestiture, numerous interexchange carriers offered stand-alone long distance to consumers, often bombarding them with dinnertime telemarketing calls and incentives to change carriers. Consumers clearly understood that they had a choice of carriers and exercised that choice. More recently, customers have moved away from purchasing stand-alone long distance service, and instead purchase any-distance services offered by a wide range of intermodal providers. As the Commission has observed, "long distance service purchased on a stand-alone basis is becoming a fringe market."[1]

These comments provide data on recent developments in the industry, including the rise of new technologies and providers, that has eliminated the historical market divisions between local and long distance services, and explain why the Commission should eliminate the antiquated equal access and nondiscrimination requirements.

## I. THERE IS EXTENSIVE COMPETITION FOR VOICE SERVICES

As described in detail in the Appendix to these comments, throughout the country, as well as in Verizon's local telephone service areas in particular, a wide variety of providers and

[1] *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd 18433, ¶ 92 (2005) ("*Verizon/MCI Order*"). *See also* Public Notice, CC Docket No. 02-39, DA 07-1071 at 1 (rel. Mar. 7, 2007) ("Public Notice") ("[T]he market appears to be shifting from competition between stand-alone long distance services to competition between service bundles including both local exchange and long distance services.").

technologies are competing with traditional voice telephone services. Many of these forms of competition did not exist – and in some cases were not even conceived – when the equal access and nondiscrimination rules were adopted more than two decades ago. These alternative providers include cable, wireless, over-the-top VoIP, and traditional wireline companies, as well as other alternatives such as e-mail, instant messaging, WiFi, WiMAX, and Broadband over Powerline ("BPL"). Since this proceeding was initiated, competition from these alternatives has grown dramatically, and is poised to increase further with the increasing deployment of advanced broadband networks that can be used to provide competitive distance-insensitive voice services.

In the past two decades, there has been massive investment to upgrade cable networks to provide voice and broadband services, and to make these networks ubiquitous. The National Cable & Telecommunications Association reports that cable companies have invested approximately $118 billion since 1996.[2] As a result of these investments, the vast majority of mass-market consumers – both nationally and in Verizon's local telephone service areas – are now able to purchase voice services from an incumbent cable operator. Cable telephone service is already available to more than three-quarters of the nation's households, and by the end of this year is expected to be available to approximately 95 percent of homes. *See* Appendix at A-2. There are currently more than 8.7 million cable telephony subscribers, and that total is increasing by an average of approximately 1.2 million subscribers each quarter. *See id.* By the end of 2010, analysts predict that cable will capture 23 percent or more of primary lines. *See id.* Cable is also investing heavily to serve enterprise customers more broadly. *See id.* at A-33 to A-36.

[2] National Cable & Telecommunications Association (NCTA), *Cable Industry Infrastructure Expenditures*, http://www.ncta.com/ContentView.aspx?contentId=56 (citing Kagan Research).

At the time the equal access and nondiscrimination rules were first adopted, the first wireless systems were just being deployed, and Commission rules permitted only two carriers per market. For the next decade, until deregulation of the industry in the 1990s, wireless growth was slow. Today, by contrast, there are substantially more wireless subscribers (217 million) than wireline access lines (172 million), and more than three quarters of U.S. households have at least one wireless phone. *See id.* at A-10 to A-11. These wireless subscribers make nearly two-thirds of their long distance calls and more than 40 percent of their local calls on their wireless phones. *See id.* at A-11. And a large and growing fraction of consumers are giving up their wireline phones entirely – roughly 13 percent today, rising to nearly 17 percent in two years, and 18-25 percent by 2010. *See id.*

Two decades ago, consumers did not even have dial-up Internet access; today, broadband connections are available to more than 90 percent of U.S. households from a provider other than the incumbent LEC, and approximately 44 percent of all households subscribe to broadband. *See id.* at A-13 to A-14. Because consumers can access competitive over-the-top VoIP services over their broadband connection, they can now choose among dozens of VoIP providers that offer voice services at prices that are comparable to or lower than prices for traditional voice service. *See id.* at A-15 & Exhibit 8. There are at least 2.7 million subscribers to these services, which are expected to displace 5 percent of primary telephone access lines by the end of 2010. *See id.* at A-15 to A-16. Moreover, a number of broadband alternatives such as WiFi, WiMax, and BPL are emerging that will make it even easier for consumers to obtain broadband and over-the-top VoIP services in the future. *See id.* at A-19 to A-22.

There are also many other competitive alternatives for voice services besides cable, wireless, and over-the-top VoIP. Traditional CLECs still serve millions of mass-market

customers, either by reselling an incumbent's local service from end-to-end, or by combining portions of an incumbent's network with their own facilities. *See id.* at A-16 to A-17. In addition, CLECs maintain a significant presence in the enterprise market, where there is also rising competition from systems integrators and equipment vendors. *See id.* at A-32. Consumers and businesses alike also are using e-mail and instant messaging ("IM") instead of making voice telephone calls, which provides an additional layer of competition. *See id.* at A-17 to A-18.

Although static market shares are not meaningful given the rapid emergence of new competitors and the trajectory of competition, an analysis that includes even just the principal alternative providers of voice service makes it clear that Verizon and other carriers do not have a position that would allow them to dominate in the long distance component of voice services, much less a position comparable to the "one-wire" state of the market that was used to justify the imposition of equal access and nondiscrimination requirements. As of June 2006, ILEC wireline access lines accounted for only approximately 28 percent of all voice connections provided to mass-market consumers, with cable, wireless, over-the-top VoIP, and other CLECs accounting for the rest. *See id.* at A-28 to A-29 & Figure 13.

## II. THERE IS A SINGLE ANY-DISTANCE COMMUNICATIONS MARKET

As the Public Notice observes, "the market appears to be shifting from competition between stand-alone long distance services to competition between service bundles including both local exchange and long distance services." Public Notice at 1. Indeed, this shift is largely complete. For purposes of this proceeding, the Commission should recognize there is no longer a separate market for stand-alone long distance services, but a single "any distance" market for communications services regardless of geography that includes both distance-insensitive services as well as any stand-alone offerings. The fact that these services all compete with one another in the same market is best evidenced by the degree to which distance-insensitive services have

supplanted previous stand-alone offerings, both as a general matter and for long distance in particular.

As described in more detail in the Appendix, in the time since this proceeding was initiated, consumers have increasingly demanded distance-insensitive communications services, and service providers have responded accordingly. Wireless carriers were in fact the pioneers in offering distance-insensitive voice services.[3] These new offerings caused many customers to use wireless services for their long distance calling, and later led to increasing displacement of wireline lines. Today, all major wireless providers offer plans with distance-insensitive buckets of minutes. *See* Appendix, Exhibits 4 & 5. Verizon and other wireline companies have responded to these plans with their own comparable offerings. *See id.*, Exhibits 6 & 7. In fact, service providers of every variety – wireline, cable, wireless, and VoIP alike – now all routinely offer distance-insensitive calling plans, which are described in detail in Exhibits 1-8 of the Appendix.

These distance-insensitive services are increasingly displacing stand-alone offerings on wireline networks, including stand-alone long distance services. According to J.D. Power and Associates, "[s]eventy-five percent of U.S. households now receive their local and long distance telephone service from one provider."[4] The number of customers purchasing distance-insensitive services has been steadily increasing each year, a trend that analysts expect will

[3] *See Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*; *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Ninth Report, 19 FCC Rcd 20597, ¶ 113 (2004).

[4] J.D. Power & Associates Press Release, *J.D. Power & Associates Reports: Three-Quarters of Households Now Bundle Local and Long-Distance Telephone Service with One Provider* (July 13, 2005).

continue.[5] As shown above and in the Appendix, moreover, consumers use wireless distance-insensitive plans in particular to make what previously would have been wireline voice long distance calls. And consumers are using other distance-insensitive services such as e-mail and IM in place of wireline voice calls as well.

Although various providers still offer stand-alone long distance services, this does not suggest there is a separate market for these services. As an initial matter, these stand-alone offerings are due in part to regulatory requirements, not market forces. State regulations often require local telephone companies to offer stand-alone local services, and the equal access rules that are the subject of this inquiry have required local telephone companies to enable customers to select a separate long distance carrier.[6] In the absence of such regulation, it is not clear there would be market-driven supply or demand for stand-alone services. As the Commission has found, regulations requiring certain offerings tend to "skew" offerings in the marketplace.[7]

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[5] *See*, *e.g.*, D. Lemelin, In-Stat, *Wireline Remains in Decline: US Wireline Service 2005* at 19 (Mar. 2006) (noting "[c]ontinued consumer migration to alternative 'any distance' voice technology, including VoIP telephony and wireless services that often bundle minutes of use, or provide unlimited minutes of local and domestic long distance.").

[6] *See*, *e.g.*, N.Y.C.R.R. 16 §§ 609.2(3) (defining "basic local exchange service") & 609.3(a) (requiring that "every telephone corporation shall provide basic local exchange service to an applicant upon his or her oral or written request."); Fla. Stat. §§ 364.02(1) (defining "basic local telecommunications service") & 364.025(1) ("Until January 1, 2009, each local exchange telecommunications company shall be required to furnish basic local exchange telecommunications service within a reasonable time period to any person requesting such service within the company's service territory."); § 220 Ill. Compiled Stat. 5/13-712 (requiring "that every telecommunications carrier meet minimum service quality standards in providing basic local exchange service on a non-discriminatory basis to all classes of customers," where "basic local exchange service" excludes vertical services); 47 U.S.C. § 251(g) (preserving the equal access requirements established prior to the 1996 Telecommunications Act).

[7] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 261 (2003) ("[R]ules requiring line sharing may skew competitive LECs'

Regardless, it is clear that any stand-alone services are disciplined by distance-insensitive services and bundles that consumers are increasingly purchasing. Different services are considered to be part of the same product market so long as they are considered reasonably interchangeable by "marginal" customers – that is, the subset of customers who will switch between the services in the putative market in response to small changes in relative prices. The Commission has recognized that in order for two competing technologies to constrain each other's prices, it "only requires that there be evidence of sufficient substitution for significant segments of the mass market," not that every customer views the two services as substitutes.[8] And, as noted above, the facts show that large numbers already have switched to distance-insensitive plans and are continuing to do so.

In any event, while the facts show there no longer is a separate long distance market, it is all the more apparent that there is no separate *wireline* long distance market. As demonstrated above and in the Appendix, consumers use cable, wireless, and VoIP services extensively in place of wireline services, including wireline long distance services. As a result, the equal access rules make no sense.

## III. THE EQUAL ACCESS AND NONDISCRIMINATION RULES ARE UNNECESSARY AND COUNTERPRODUCTIVE

The equal access and nondiscrimination requirements of Section 251(g) are a by-product of the 1984 divestiture of the Bell System from AT&T. The consent decree effecting the divestiture and the Commission imposed the equal access and nondiscrimination requirements on

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incentives toward providing a broadband-only service to mass market consumers, rather than a voice-only service or, perhaps more importantly, a bundled voice and xDSL service offering.").

[8] *Verizon/MCI Order* ¶ 91.

the BOCs to make sure that they did not continue to treat AT&T as if they were still affiliated. As the court overseeing entry of the decree explained:

> Although after divestiture the Operating Companies will no longer have the same incentive to favor AT&T, a substantial AT&T bias has been designed into the integrated telecommunications network, and the network, of course, remains in that condition.[9]

The restrictions of the AT&T divestiture decree, therefore, were not broad "nondiscrimination" prohibitions. Instead, they were narrowly focused provisions designed to complement the divestiture requirement, and they were designed to make sure the divested BOCs would not continue to favor their former parent, AT&T. Given the developments in the marketplace in the intervening two-plus decades, these rules are unnecessary and counterproductive.

First, under current market conditions, there is no plausible argument that traditional wireline carriers could use their local networks to dominate the provision of voice long distance service (*e.g.*, by favoring their own long distance operations, the way the Decree feared the BOCs would favor AT&T). As demonstrated above, there are now many competitive alternatives available that do not rely on the wireline local network, and consumers are using these alternatives to a large and increasing extent, both as a general matter and for their voice long distance calls in particular. In 2006, cable, wireless, VoIP, and wireline providers added a *net* total of approximately 21 million subscribers, which indicates that a large fraction of mass-market customers are switching between these various alternatives, or switching between various

[9] *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 195 (D.D.C. 1982), *aff'd sub nom., Maryland v. United States*, 460 U.S. 1001 (1983).

providers, at any given point in time.[10] Moreover, this is a conservative total because *gross* adds, which providers generally do not report, are undoubtedly higher due to customer churn.

Second, the equal access and nondiscrimination rules in fact discriminate against the Bell Companies and run counter to the Commission's goal of ensuring a level playing field for all competitors. Only the Bell companies and GTE are subject to these rules, which puts them at a distinct disadvantage vis-à-vis cable operators and other competitive providers. Other competitors are free to structure their service offerings to respond to market forces, while the Bell companies must conform their offerings to outdated regulations. This violates well-settled policies favoring a level regulatory playing field for new investment. As the Commission has held, "it is in the public interest to place intermodal competitors on an equal regulatory footing by ending unequal regulation of services provided over different technological platforms."[11] The Commission will "neither unfairly favor nor disfavor one technology over another."[12] Given the extensive competition that now exists for voice services, asymmetrical regulation imposes artificial price constraints that impede full competition among providers and harms consumers.[13]

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[10] J. Chaplin, *et al.*, JPMorgan, *Telecom Services/Wireline: State of the Industry: Consumer* at Table 21 (Jan. 13, 2006) (estimated net adds for VoIP lines); J. Chaplin, *et al.*, JPMorgan, *Telecom Services/Wireline: Fourth Quarter 2006 Preview* at Tables 12 & 23 (Jan. 23, 2007) (net adds for cable, ILEC, and wireless lines).

[11] *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415, ¶ 78 (2005).

[12] *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, ¶ 47 (1997).

[13] *See, e.g.*, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶¶ 45, 71, 79 & n.241 (2005).

Finally, imposing equal access and nondiscrimination obligations only on a subset of providers harms consumers by needlessly reducing efficiency, increasing cost, and hindering deployment of advanced broadband networks and services. To the extent these rules continue to apply to LECs, they will reduce the incentives and ability for Verizon and other carriers to deploy new services, including advanced broadband networks.

These new networks and services do not conform to any geographic boundaries, much less the artificial boundaries traditionally used to define and regulate separate local and long distance services and markets. These advanced networks are instead designed to provide multiple services – voice, data, and in some cases, video – using packet switches, computer servers, and other types of equipment that may be located more efficiently at some distance from the end user. As the Commission has noted, "[f]ully evolved digital broadband will virtually eliminate geographic distance as an obstacle to acquiring information, and dramatically reduce the time it takes to access information."[14] Imposing regulation on these networks and services based on the artificial service and geographic categories of the past impedes the ability of providers to deploy these networks and services based on the most efficient engineering and business considerations, and requires instead that they conform to outdated regulatory requirements. By reducing the efficiency of these new networks, such regulation would delay or deter their deployment, contrary to Congress's and the Commission's stated goals of promoting broadband deployment.[15]

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[14] *Service Rules and Procedures to Govern the Use of Aeronautical Mobile Satellite Service Earth Stations in Frequency Bands Allocated to the Fixed Satellite Service*, Notice of Proposed Rulemaking, 20 FCC Rcd 2906, ¶ 2 (2005).

[15] *See, e.g., Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶ 77 (2005); 47 U.S.C. § 157 nt. (Section 706 of the Act).

In sum, maintaining section 251(g)'s equal access and nondiscrimination requirements is not only unnecessary to ensure just, reasonable, and nondiscriminatory rates and to protect consumers, but it would be affirmatively detrimental to competition and harmful to the public interest.

## CONCLUSION

For the reasons set forth herein, the Commission should eliminate the equal access and nondiscrimination requirements.

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## APPENDIX: COMPETITION FOR VOICE SERVICES

### A. Mass-Market

Mass-market consumers have access to a wide range of communications alternatives for voice services.

#### 1. Cable

The Commission has repeatedly found that cable voice services "compete as substitutes" for wireline telecommunications service offerings.[16] Forward-looking state regulators around the country have reached the same conclusion.[17] These determinations are obviously correct.

As shown in Figure 1, both the availability and use of cable telephony have grown significantly since the Commission initiated this proceeding. The vast majority of mass-market consumers – both nationally and in Verizon's local telephone service areas – are now able to

[16] *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd 19415, ¶ 65 (2005); *see also Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd 18433, ¶¶ 87-88 (2005) ("*Verizon/MCI Order*") (holding that "facilities-based VoIP providers" that "own and control the last mile facility" "clearly fall within the relevant service market for local service." These services "have many similar characteristics to traditional wireline local service" and are viewed by mass-market customers "as sufficiently close substitutes for local service.").

[17] *See, e.g.*, *Proceeding on Motion of the Commission To Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings at 33-34, Case 05-C-0616 (N.Y.P.S.C. Apr. 11, 2006) ("*New York Pricing Flexibility Order*") (finding that "facilities-based digital phone service (i.e., cable phone)" is "widely available in New York and that from the perspective of customer demand they are sufficiently close substitutes for traditional wireline local service. . . . In our judgment, consumers view these offerings as close substitutes to wireline local service."); *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the Regulation of Telecommunications Utilities*, Opinion, Rulemaking 05-04-005, Decision 06-08-030 at 119-120 (Cal. P.U.C. Aug. 24, 2006) ("*California Regulatory Reform Order*") (finding that VoIP services, including those provided by cable operators, "are competitors to wireline telecommunications services" and are a "close substitute for wireline services").

purchase voice services from an incumbent cable operator. Cable telephone service is already available to more than three-quarters of the nation's households,[18] and by the end of this year is expected to be available to approximately 95 percent of homes.[19] Cable operators are offering distance-insensitive voice services, *see* Exhibits 1 (examples of cable voice offerings) & 3 (cable websites advertising voice offerings), and have had great success selling these services. There are currently more than 8.7 million cable telephony subscribers, with that total increasing by an average of approximately 1.2 million subscribers each quarter.[20] JPMorgan estimates that, by the end of 2010, cable will capture 23 percent of primary lines.[21] Other analysts predict that cable will achieve even higher percentages.[22]

[18] *See* C. Moffett, *et al.*, Bernstein Research, *VoIP: The End of the Beginning* at Exhibit 3 (Apr. 3, 2007) ("*Bernstein VoIP Report*") (estimating cable telephony availability of 76 percent of U.S. households as of year-end 2006). *See also* Comments of the National Cable & Telecommunications Association at 45, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 06-189 (FCC filed Nov. 29, 2006) ("*NCTA Comments*") ("Cable telephone service is now available to more than 73% of the nation's households, and it is already being purchased by 8.5 million customers.").

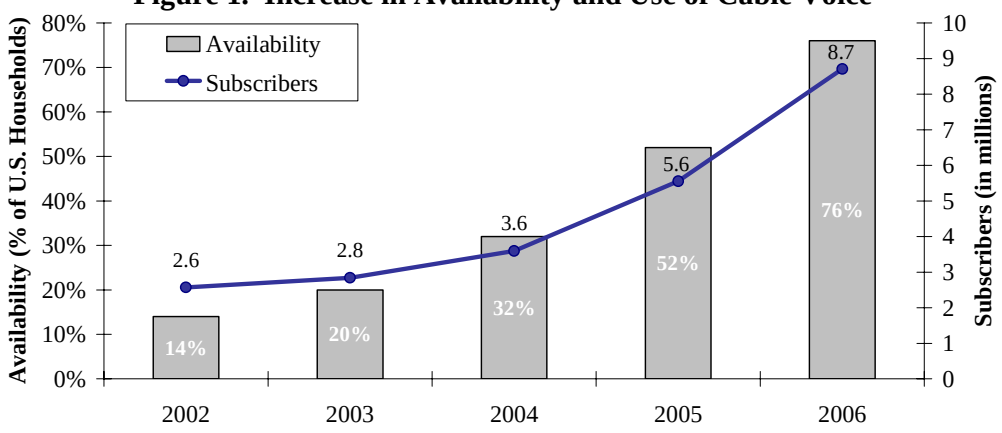
[19] *See Bernstein VoIP Report* at Exhibit 3 (estimating cable telephony availability of 95 percent of U.S. households by year-end 2007, and 99 percent of households by year-end 2008).

[20] *Bernstein VoIP Report* at Exhibit 8.

[21] J. Chaplin, *et al.*, JPMorgan, *Telecom Services/Wireline: State of the Industry: Consumer* at Table 21 (Jan. 13, 2006) (estimating that cable will have a 23 percent share of wireline primary lines by the end of 2010).

[22] *See, e.g.*, F. Louthan, *et al.*, Raymond James Equity Research, *Reassessment of Access Lines and Wireline Carriers* at 3 (July 5, 2006) (citing IDC estimates that cable will enjoy a share of more than 30 percent of all primary lines by the end of 2010).

**Figure 1. Increase in Availability and Use of Cable Voice**




*Sources:* J. Halpern, *et al*., Bernstein Research, *Quarterly VoIP Monitor: VoIP Growth Still Accelerating* at Exhibits 12 & 13 (Apr. 18, 2006) (2002); C. Moffett, *et al.*, Bernstein Research, *VoIP: The End of the Beginning* at Exhibits 3 & 8 (Apr. 3, 2007) (2003-2006).

Each of the four major incumbent cable operators – Cablevision, Time Warner, Comcast, and Cox – offers competitive voice services in their service territories. Based on the number of homes these companies claim to pass with their networks, these four companies' networks pass more than 75 percent of the homes in the country.[23] Analysts also estimate that these cable operators cover approximately 72 percent of homes in Verizon's local telephone service areas.[24] As of the end of first quarter 2007, these cable companies had already won approximately 8.6 million voice subscribers.[25] According to these same sources, these four companies were collectively adding approximately 70,000 new subscribers each week.[26]

[23] *See* Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007); Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007); Cablevision Press Release, *Cablevision Systems Corporation Reports First Quarter 2007 Results* (May 3, 2007); Cox News Release, *Cox Communications Announces Updated Customer Statistics Following System Sales & Acquisitions* (June 14, 2006); *Bernstein VoIP Report* at Exhibit 3 (total U.S. households as of year-end 2006).

[24] J. Halpern, *et al.*, Bernstein Research, *US Telecom: Full Valuations and High Expectations Drive Less Bullish Outlook for 2007 Than 2006* at Exhibit 8 (Nov. 13, 2006).

[25] *See* Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007); Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007); Cablevision Press Release, *Cablevision Systems Corporation*

*Comcast* is the largest provider of cable television service in the U.S. Its network passes nearly 48 million homes nationwide.[27] According to analysts, approximately one-third of those homes – roughly 16 million – are in Verizon's local telephone service areas.[28] Comcast has stated that it was offering voice service to approximately 35 million homes (73 percent of its footprint) as of the end of first quarter 2007, and that it would reach 85 percent of its footprint by year-end 2007.[29] In April 2007, Comcast reported that it was providing voice service to more than 2.9 million customers nationwide as of the end of first quarter 2007, and that it was adding an average of nearly 37,000 customers per week.[30] In May 2007, the company reported that it "now expect[s] Comcast Digital Voice penetration to *exceed* 20% by the end of 2009," and

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*Reports First Quarter 2007 Results* (May 3, 2007); Cox News Release, *Cox Answers the Phone and Says "Hello" to Continued Growth* (May 1, 2007).

[26] *See* Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007); Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007); Cablevision Press Release, *Cablevision Systems Corporation Reports First Quarter 2007 Results* (May 3, 2007); Cox News Release, *Cox Answers the Phone and Says "Hello" to Continued Growth* (May 1, 2007); Cox News Release, *A Decade of Bundling Delivers Cox Communications Considerable Competitive Advantages* (Jan. 30, 2007).

[27] Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007).

[28] *See* J. Halpern, *et al.*, Bernstein Research, *US Telecom: Full Valuations and High Expectations Drive Less Bullish Outlook for 2007 Than 2006* at Exhibit 9 (Nov. 13, 2006); Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007).

[29] Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007); Comcast Analyst and Investor Day Presentation at 68 (May 1, 2007), http://media.corporate-ir.net/media_files/irol/11/118591/AnalystDay2007/juliano2.pdf.

[30] *See* Comcast Press Release, *Comcast Reports First Quarter 2007 Results* at Table 6 (Apr. 26, 2007).

revised its projection to 20-25 percent of available homes passed by 2009.[31] "The momentum our voice product has experienced since it was launched is simply staggering," noted Comcast's senior vice president and general manager for voice services.[32] "This year we become the fourth largest phone company in America and we've been in the business for two years," remarked Comcast's chairman.[33]

*Time Warner Cable*, the nation's second largest cable operator, passes more than 26 million homes nationwide.[34] According to analysts, approximately one-quarter of those homes – roughly 6.5 million – are in Verizon's local telephone service areas.[35] Time Warner Cable offers voice service in every market it served prior to its recent transactions with Adelphia and Comcast (markets in which Time Warner passed more than 16 million U.S. homes),[36] and following those

[31] Comcast Press Release, *Comcast Outlines Growth Strategy and Company Prospects at 2007 Analyst and Investor Meeting* (May 1, 2007) (statement by Comcast Chairman and CEO Brian Roberts) (emphasis added); Comcast Analyst and Investor Day Presentation at 68 (May 1, 2007), http://media.corporate-ir.net/media_files/irol/11/118591/AnalystDay2007/juliano2.pdf.

[32] Comcast Press Release, *Comcast Passes Its Two Million Comcast Digital Voice® Customer Milestone* (Mar. 1, 2007) (citing Cathy Avgiris).

[33] *Comcast Investor Day A.M. Session – Final*, FD (Fair Disclosure) Wire, Transcript 050107ai.739 (May 1, 2007) (statement by Comcast Chairman and CEO Brian Roberts).

[34] Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007).

[35] *See* J. Halpern, *et al.*, Bernstein Research, *US Telecom: Full Valuations and High Expectations Drive Less Bullish Outlook for 2007 Than 2006* at Exhibit 9 (Nov. 13, 2006); Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007).

[36] Thomson StreetEvents, *TWX – Q4 2004 Time Warner Inc. Earnings Conference Call*, Conference Call Transcript (Feb. 4, 2005) (statement of Time Warner Inc. CFO Wayne Pace).

transactions provides voice service to approximately 66 percent of its 26 million homes passed.[37] In May 2007, Time Warner reported that it had approximately 2.2 million voice subscribers nationwide as of the end of first quarter 2007, and that it was adding an average of 17,000 customers each week.[38] Time Warner Cable states that its subscribers to Digital Phone service are "growing rapidly," that this service "has been a remarkable success," and that its Digital Phone penetration of service-ready homes was 12 percent as of the end of first quarter 2007.[39]

*Cablevision's* network passes approximately 4.6 million homes nationwide.[40] According to analysts, nearly 80 percent, or 3.6 million homes, are in Verizon's local telephone service areas.[41] In 2003, Cablevision became the first cable operator in the U.S. to deploy IP-based telephone service *throughout* its cable service territory.[42] In May 2007, Cablevision reported that it serves more than 1.3 million voice subscribers, and was adding an average of more than 8,000 voice subscribers each week.[43] Cablevision also reported that it is the voice provider for

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[37] Time Warner Inc. Press Release, *Time Warner Inc. Reports Results for 2006 Full Year and Fourth Quarter* (Jan. 31, 2007); Time Warner Inc., *2006 Trending Schedules* at Schedule 6, http://ir.timewarner.com/downloads/4Q06Trending.pdf.

[38] *See* Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007) (Digital Phone and circuit-switched subscribers).

[39] Comments of Time Warner Cable at 4-5, WC Docket No. 06-172 (FCC filed Mar. 5, 2007); Time Warner Cable Press Release, *Time Warner Cable Reports 2007 First Quarter Results* at Table 3 (May 2, 2007).

[40] Cablevision Press Release, *Cablevision Systems Corporation Reports First Quarter 2007 Results* (May 3, 2007).

[41] *See* J. Halpern, *et al.*, Bernstein Research, *US Telecom: Full Valuations and High Expectations Drive Less Bullish Outlook for 2007 Than 2006* at Exhibit 9 (Nov. 13, 2006); *see also id.* at 7-8 ("Cablevision . . . is almost entirely in Verizon's footprint.").

[42] Cablevision News Release, *Cablevision Completes Network Rebuild* (Dec. 3, 2003).

approximately 29 percent of the homes it passes, and analysts expect this to increase to more than 34 percent by the end of 2007.[44]

*Cox Communications'* network passes more than 9 million homes nationwide.[45] According to analysts, approximately 16 percent, or 1.5 million homes, are in Verizon's local telephone service areas.[46] In October 2006, Cox announced that its Digital Telephone service was available in all Cox markets.[47] In May 2007, Cox reported that it "gained a record number of new telephone customers in the last twelve months of operations" with a 21 percent year-over-year increase, and that it was providing voice service to 2.1 million homes as of the end of first quarter 2007.[48] Cox is adding nearly 8,000 voice subscribers each week.[49] Cox reported in July

[43] Cablevision Press Release, *Cablevision Systems Corporation Reports First Quarter 2007 Results* (May 3, 2007).

[44] *Id.*; A. Noto, *et al.*, Goldman Sachs, *1Q2007 Outlook: Strong Quarter Expected Almost Across the Board* at Exhibit 11 (Apr. 24, 2007). *See also* C. Moffett, *et al.*, Bernstein Research, *Cable 3Q Preview: Raising Target Prices for Comcast and Cablevision; Risk/Reward Still Positive* at 15 & Exhibit 23 (Oct. 19, 2006); Cablevision News Release, *Cablevision's Optimum Voice Surpasses One Million Customers* (July 18, 2006) (Tom Rutledge, Cablevision chief operating officer: Optimum Voice "has already been embraced by one-third of [Cablevision's] cable television customers and more than half of [the company's] high-speed Internet customers.").

[45] Cox News Release, *Cox Communications Announces Updated Customer Statistics Following System Sales & Acquisitions* (June 14, 2006).

[46] *See* J. Halpern, *et al.*, Bernstein Research, *US Telecom: Full Valuations and High Expectations Drive Less Bullish Outlook for 2007 Than 2006* at Exhibit 9 (Nov. 13, 2006); Cox News Release, *Cox Communications Announces Updated Customer Statistics Following System Sales & Acquisitions* (June 14, 2006).

[47] *See* Cox News Release, *Cox Digital Telephone Now Offered in All Cox Markets* (Oct. 30, 2006).

[48] Cox News Release, *Cox Answers the Phone and Says "Hello" to Continued Growth* (May 1, 2007).

2006 that it already provides voice services to "33 percent of total cable customers and 24 percent of all homes passed by Cox's network."[50]

*Bright House Networks* is the nation's sixth largest cable operator, with over 2.2 million customers in several large markets, including Tampa, which is one of the country's largest cable clusters.[51] The company launched phone service in Verizon's local telephone service areas in Florida in 2004, and as of May 2006 reported that it had already gained more than 225,000 customers.[52] Press reports put that total at more than 300,000 as of December 2006.[53] This is consistent with the company's claim that it "is signing up 8,000 to 10,000 new customers for its voice product every month."[54]

*Charter Communications* passes approximately 11.7 million homes and has reported that it has more than 5.4 million cable subscribers.[55] According to Charter, approximately 20

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[49] *See id.*; Cox News Release, *A Decade of Bundling Delivers Cox Communications Considerable Competitive Advantages* (Jan. 30, 2007).

[50] Cox News Release, *Cox Digital Telephone To Be Available in All Cox Markets by End of Year* (July 13, 2006).

[51] Bright House Networks Press Release, *Bright House Networks Adds Digital Phone Features* (Nov. 27, 2006); Bright House Networks, *Company Overview,* http://www.mybrighthouse.com/about_us/company_overview.aspx.

[52] Bright House Networks Press Release, *More Than 225,000 Florida Families Switch to Bright House Networks Digital Phone* (May 2, 2006).

[53] R. Roger, *Cable Operators Seek Competitive Edge,* Bradenton Herald at 1 (Dec. 17, 2006).

[54] L. Mayk, *Battle for Your Bills Heats Up,* Sarasota Herald-Tribune at 16 (Oct. 30, 2006) (quoting company spokesman Joe Durkin).

[55] Charter Communications Press Release, *Charter Reports First-Quarter Financial and Operating Results* (May 3, 2007).

percent, or 2.4 million of these homes passed, are in Verizon's local telephone service areas.[56] The company has reported that it had deployed telephony services to approximately 7.3 million homes, or approximately 62 percent of homes passed, as of the end of first quarter 2007.[57] In May 2007, the company announced that it now serves more than 572,000 voice customers.[58] Charter has stated that it plans to continue expanding the availability of its service.[59]

In addition to the larger cable operators discussed above, many of the smaller cable operators in Verizon's local telephone service areas also are capable of and are providing voice services in their service territories. For example, as shown in Exhibit 2, cable operators such as RCN, Atlantic Broadband, Knology, Mediacom, and others all offer voice services in Verizon's local telephone service areas.

**2. Wireless**

The Commission has recognized that "growing numbers of particular segments of the mass market are choosing mobile wireless service in lieu of wireline local services," and that wireless is competing with wireline both for minutes of use and, in many cases, for subscriber lines.[60] The Commission has further noted that it is not necessary that all segments of the mass market be likely to rely upon mobile wireless services in lieu of wireline local services in order

[56] *Charter at Citigroup 17th Annual Entertainment, Media and Telecommunications Conference – Final*, FD (Fair Disclosure) Wire, Transcript 011007au.742 (Jan. 10, 2007) (statement by Charter president and CEO Neil Smit).

[57] Charter Communications Press Release, *Charter Reports First-Quarter Financial and Operating Results* (May 3, 2007).

[58] *Id*.

[59] *Id.* ("During 2007, Charter will continue to focus on driving deeper penetration of telephone service and bundled service packages, while further expanding our telephone footprint.").

[60] *Verizon/MCI Order* ¶ 91.

for wireless service to constrain prices for wireline service, but rather the analysis "only requires that there be evidence of sufficient substitution for significant segments of the mass market."[61] The Commission also found that the evidence shows that "intermodal competition between mobile wireless and wireline service will likely increase in the near term."[62] That conclusion is borne out by ongoing developments, both generally and with respect to the long distance component of voice services in particular.

As an initial matter, wireless carriers were the pioneers in offering distance-insensitive voice services.[63] These new offerings caused many customers to use wireless services for their long distance calling, and later led to increasing displacement of wireline lines. Today, all major wireless providers offer plans with distance-insensitive buckets of minutes. *See* Exhibits 4 (describing wireless offerings) & 5 (maps of major wireless providers in Verizon's local telephone service areas). Verizon and other wireline companies have responded to these plans with their own comparable offerings. *See* Exhibits 6 & 7 (describing wireline offerings carriers in Verizon's local telephone service areas).

Mass-market customers are increasingly using wireless services in place of traditional wireline telephone services. As of June 2006, there already were substantially more wireless subscribers (217 million) than wireline access lines (172 million).[64] As shown in Figure 2, this

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[61] *Id.*

[62] *Id.*

[63] *See Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*; *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Ninth Report, 19 FCC Rcd 20597, ¶ 113 (2004).

[64] *See* Ind. Anal. & Tech. Div., WCB, FCC, *Local Telephone Competition: Status as of June 30, 2006* at Tables 1 & 14 (Jan. 2007) ("*FCC June 2006 Local Competition Report*").

represents a significant increase since the Commission initiated this proceeding. As of the end of 2006, more than 76 percent of U.S. households had at least one wireless phone.[65] Analysts have estimated that wireless subscribers make 64 percent of their long distance calls and 42 percent of their local calls on their wireless phones.[66] A large and increasing number of customers are giving up their wirelines entirely in favor of wireless. CIBC estimates that 12.8 percent of wireline access lines have been lost to wireless, and that the total will rise to 16.7 percent within two years.[67] Analysts predict that the number of wireless-only users will grow to 18-25 percent of the market by 2010.[68]

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[65] CTIA, *Wireless Quick Facts: December 2006*, http://www.ctia.org/media/industry_info/index.cfm/AID/10323.

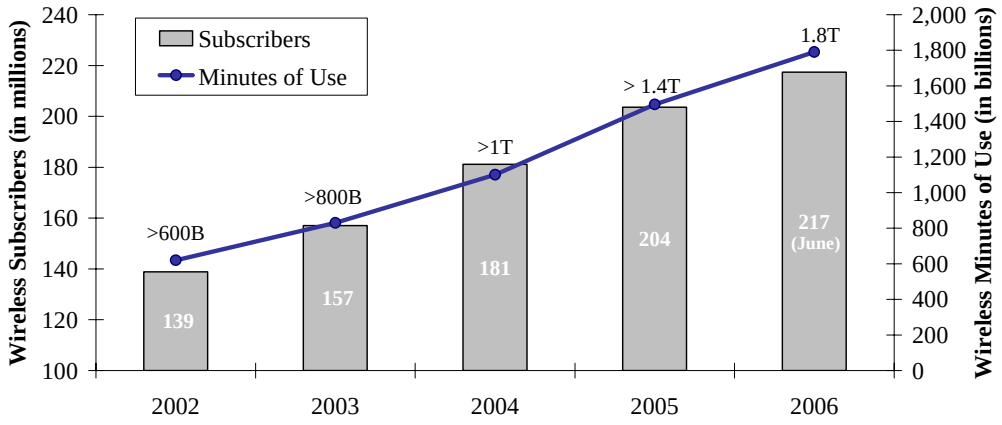
[66] K. Griffin, Yankee Group, *Pervasive Substitution Precedes Displacement and Fixed-Mobile Convergence in Latest Wireless Trends* at 5 and Exhibit 3 (Dec. 2005); *see also* D. Chamberlain, *et al.*, In-Stat, *Wireless in the Consumer Telecom Bundle: Discounts without Convergence* at 15 (Oct. 2005) (19 percent of survey respondents transferred *all* long distance calling to wireless); Pew Internet & American Life Project, *Pew Internet Project Data Memo: Cell Phone Use* at 4 (Apr. 2006) (26 percent of Americans surveyed said they couldn't live without a wireless phone).

[67] T. Horan, *et al.*, CIBC World Markets, *4Q06 Communications and Cable Services Preview*, at Exhibit 8 (Jan. 18, 2007). *See also* B. Bath, Lehman Brothers, *Telecom Services – Wireline* at Figure 11 (July 7, 2005) (estimating 24 million wireline access lines have been lost to wireless providers since 1999); S. Blumberg, *et al.*, Center for Disease Control and Prevention (CDC), *Wireless Substitution: Early Release of Estimates Based on Data from the National Health Interview Survey, July - December 2006* (May 14, 2007), http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200705.pdf (estimating that at least 12.8 percent of U.S. homes had only wireless phones in the second half of 2006).

[68] *See* F. Louthan, *et al.* Raymond James Equity Research, *Reassessment of Access Lines and Wireline Carriers* at 2 (July 5, 2006) (predicting 25 percent wireless substitution by 2010); R. Bilotti, *et al.*, Morgan Stanley, *Cable/Satellite: Looking into 3Q06 and 2007: Cautious on Top Line, Capital Expenditures, and Lofty Valuations* at Exhibit 53 (Oct. 25, 2006) (predicting 20 percent wireless substitution by the end of 2009); V. Shvets, *et al*., Deutsche Bank, *4Q04 Review: Wireless OK . . . RBOCs Fare Poorly* at 6 (Feb. 28, 2005) ("wireless cannibalization" now accounts for "more than 1m lines lost per quarter."); J. Chaplin, *et al.*, JP Morgan, *State of the Industry: Consumer* at Table 57 (Jan. 13, 2006) (estimating that, by the end of 2010, wireless will capture 18 percent of primary lines).

Wireless prices have continued to decline, which has led increasing numbers of consumers to use wireless in place of wireline to make their calls. All major wireless carriers offer voice services that are competitive with comparable wireline offerings with respect to price. *See* Exhibit 4 (describing wireless offerings). The coverage and reliability of wireless networks has continued to improve due to investments by wireless providers,[69] and the overwhelming majority of consumers are satisfied with the quality of their wireless service.[70]

**Figure 2. Increase in Wireless Usage**




*Sources:* Ind. Anal. & Tech. Div., WCB, FCC, *Local Telephone Competition: Status As of June 30, 2006* at Table 14 (Jan. 2007); CTIA, *CTIA's Wireless Industry Indicies: Year-End 2003 Results* (May 2004); CTIA, *Background on CTIA's Semi-Annual Wireless Industry Survey* (Year-End 2004 & 2005; 1H06); CTIA, *Wireless Quick Facts* , http://www.ctia.org/media/industry_info/index.cfm/AID/10323 (2H06).

### 3. Over-the-Top VoIP

The Commission has found that "some proportion of mass market customers may view certain over-the-top VoIP services as substitutes for wireline local service."[71] This turns on whether consumers purchase broadband connections, or have them available to purchase, and on

[69] *See Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, Eleventh Report, 21 FCC Rcd 10947, ¶¶ 132-134 (2006).

[70] CTIA Press Release, *Consumers Remain Overwhelmingly Satisfied with their Wireless Service, New Poll Finds* (Sept. 13, 2006) (An August 2006 survey by McLaughlin & Associates found that 86 percent were satisfied with their wireless phone service).

[71] *Verizon/MCI Order* ¶ 89.

their particular local service requirements.[72] A number of state regulators have recognized that these conditions are now met and that over-the-top VoIP services are a substitute for traditional wireline services.[73]

As an initial matter, any customer with a broadband connection can obtain voice service from one of these VoIP providers. This is particularly significant because broadband is now available to more than 90 percent of U.S. households from a provider other than the incumbent LEC.[74] *See* Figure 3.

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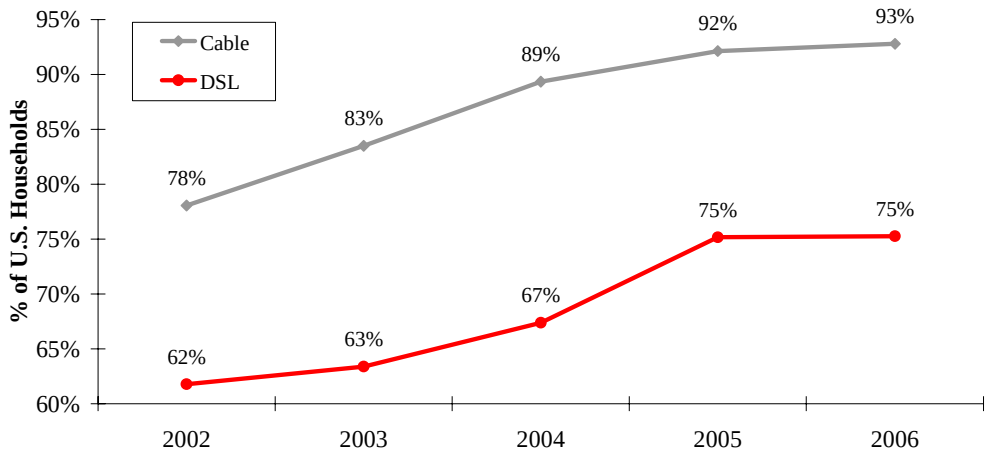
[72] *See id.*

[73] *See, e.g.*, *New York Pricing Flexibility Order* at 33-34 (Concluding that "application based phone service (e.g., Vonage)" is "widely available in New York and that from the perspective of customer demand they are sufficiently close substitutes for traditional wireline local service. . . . In our judgment, consumers view these offerings as close substitutes to wireline local service."); *California Regulatory Reform Order* at 119-120 ("VoIP communications are competitors to wireline telecommunications services"; "VoIP is a close substitute for wireline service."); *Joint Application of Verizon Communications, Inc. and MCI, Inc. for Approval of Agreement and Plan of Merger*, Opinion and Order, Docket Nos. A-310580F0009, *et al.*, 2006 Pa. PUC LEXIS 22 at *132 (Pa. P.U.C. Jan. 11, 2006) ("The presence of substitutes or alternatives such as cable telephony, and VoIP, for the mass market customer class, particularly for the provision of local service, are a sufficient constraint on the exercise of market power and potentially anti-competitive behavior."); Div. of Competitive Markets and Enforcement, Florida PSC, *Report on the Status of Competition in the Telecommunications Industry: As of May 31, 2006* at 66, 2 (Dec. 2006) (VoIP services "are successfully providing competitive alternatives to both residential and business subscribers." The PSC noted "the increasing acceptance of intermodal competitors, especially wireless and Voice over Internet Protocol (VoIP) service providers, as adequate substitutes for wireline telecommunications service by the consuming public.").

[74] *See, e.g.*, NCTA Presentation, *Competition Works. Consumers Win!, Competition, Choice and Value Shape Today's Communications Marketplace* at 5 (Mar. 2007), http://i.ncta.com/ncta_com/PDFs/Consumers_Win_03.09.07.pdf (citing Kagan Research); S. Flannery, *et al.*, Morgan Stanley, *Cable & Telecom: As Broadband Matures, Speeds (and CapEx) Rise* at Exhibits 19 & 22 (Apr. 23, 2007) (estimating 107.5 million homes passed by cable broadband as of year-end 2006).

**Figure 3. Increase in Broadband Availability**

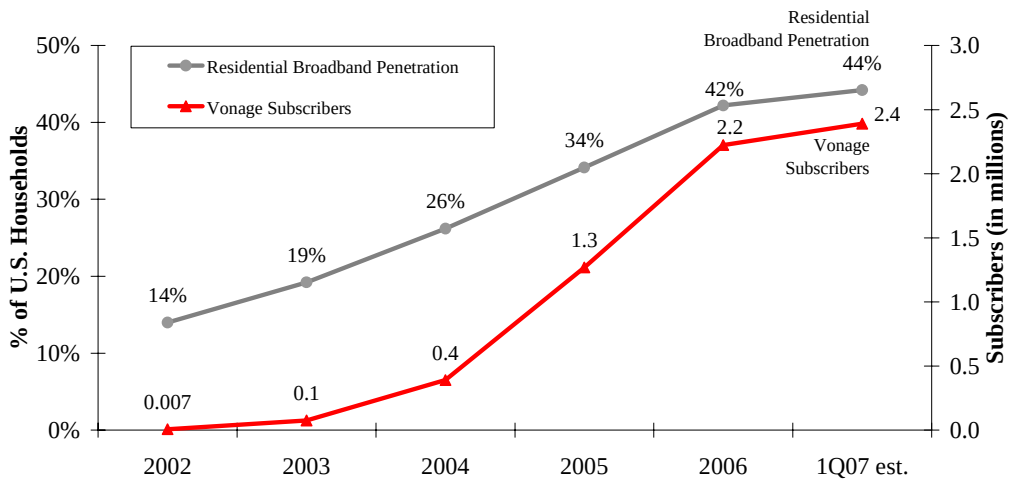



*Source:* S. Flannery, *et al.*, Morgan Stanley, *Telecom Services: Speed Is Key As Broadband Market Matures* at Exhibit 10 (Jan. 26, 2007); S. Flannery, *et al.*, Morgan Stanley, *Cable & Telecom: As Broadband Matures, Speeds (and CapEx) Rise* at Exhibits 19 & 22 (Apr. 23, 2007).

Moreover, a significant and rapidly growing portion of mass-market customers subscribes to broadband service, approximately 44 percent as of the end of first quarter 2007,[75] while many more customers have broadband available to them. As shown in Figures 3 & 4, the availability and use of broadband have grown significantly since the Commission initiated this proceeding, as has the use of broadband to obtain over-the-top VoIP services.

[75] S. Flannery, *et al.*, Morgan Stanley, *Cable & Telecom: As Broadband Matures, Speeds (and CapEx) Rise* at Exhibit 21 (Apr. 23, 2007) (estimate for 1Q07).

**Figure 4. Increase in Availability and Use of Over-the-Top VoIP Services**




*Sources:* S. Flannery, *et al.*, Morgan Stanley, *Telecom Services: Speed Is Key As Broadband Market Matures* at Exhibit 10 (Jan. 26, 2007); S. Flannery, et al., Morgan Stanley, *Cable & Telecom: As Broadband Matures, Speeds (and CapEx) Rise* at Exhibit 21 (Apr. 23, 2007).J. Hodulik, *et al*., UBS, *The Vonage Story* at 4 (Nov. 24, 2003); Vonage, Form 10-Q (SEC filed Aug. 4, 2006); Vonage Press Release, *Vonage Holdings Corp. Reports Fourth Quarter and Full Year 2006 Results* at Table 2 (Feb. 15, 2007); Vonage Press Release, *Vonage Holdings Corp. Reports First Quarter 2007 Results* at Table 2 (May 10, 2007).

Over-the-top VoIP services were first embraced principally by consumers who make large volumes of international and long distance calls, and now appeal to consumers generally and compete directly with traditional wireline service offerings. Indeed, as shown in Exhibit 8, there are dozens of over-the-top VoIP providers in Verizon's local telephone service areas that offer voice services at prices that are comparable to or lower than Verizon's prices.

The fact that over-the-top VoIP services are viewed as an alternative to traditional voice service is evidenced by the numbers of customers switching to these services. As of year-end 2006, analysts reported that over-the-top VoIP providers served at least 2.7 million subscribers.[76] SunRocket recently announced that has "[b]uil[t] a 200,000 subscriber base from scratch in a relatively short period of time," which it claims "demonstrates how rapidly consumers are embracing the value, simplicity and enhanced feature set of SunRocket Internet phone service."[77]

[76] *See Bernstein VoIP Report* at Exhibit 1.

[77] SunRocket Press Release, *SunRocket Breaks Through 200,000 Subscriber Milestone* (Apr. 2, 2007) (statement by SunRocket President and CEO Lisa Hook).

Analysts estimate that over-the-top VoIP providers will displace 5 percent of primary telephone access lines by the end of 2010.[78]

For customers who have not yet subscribed to broadband service, analysts have determined that the combination of broadband service and VoIP is competitive with what customers pay for a narrowband combination of local, long distance and dial-up Internet access.[79] The quality of over-the-top VoIP services also is sufficient for most users. In fact, most customers who subscribe to VoIP view it as a replacement for their primary telephone line. For example, analysts have reported that approximately 60-70 percent of over-the-top VoIP subscribers port their telephone numbers.[80]

#### 4. Traditional CLECs

Although declining in importance relative to intermodal competitors, there are still a number of traditional CLECs that provide distance-insensitive voice services to mass-market customers. *See* Exhibit 7 (describing offerings of traditional CLECs). According to the

[78] *See* J. Chaplin, *et al.*, JPMorgan, *Telecom Services/Wireline: State of the Industry: Consumer* at Table 21 (Jan. 13, 2006).

[79] *See* M. Rollins, *et al.*, Citigroup, *Share Wars – Telco vs. Cable* at 7 (Oct. 5, 2005) (The average narrowband household could capture a net savings of $6 per month by subscribing to broadband and migrating to VoIP service. Assumes $50 a month landline service & $21 a month dial-up, replaced by $40 a month cable modem service and an independent VoIP provider at $25 a month); C. Moffett, *et al.*, Bernstein, *Quarterly VoIP Monitor: The "Halo Effect" of VoIP is Driving Faster Subscriber Growth* at 4 (Sept. 2, 2005) ("[T]he bundled price of VoIP and broadband is compelling to dial-up subscribers, for whom the cost of upgrading to broadband is more than offset by the savings on telephony.").

[80] *See* D. Shapiro, *et al.*, Banc of America Securities, *Battle for the Bundle* at 30 (June 14, 2005).

Commission's most recent Local Competition Report, CLECs reported serving more than 6 million mass-market lines as of June 2006, not including lines served by cable companies.[81] Following the Commission's finding of no impairment for switching, Verizon began offering its Wholesale Advantage service, which provides the same features and functionality of the UNE platform but at negotiated market rates.[82] As of December 2006, more than 100 competitors were serving approximately 1.5 million residential lines using Wholesale Advantage, and more than 150 competitors were serving more than 150,000 residential lines using Verizon's resale offerings. Still other competitors are offering voice services to mass-market customers by combining their own facilities with wholesale service purchased from Verizon.

**5. Additional Competitive Alternatives**

Changes in technology have opened the door for a variety of other types of services to compete with traditional wireline voice service.

*First*, e-mail and instant messaging ("IM") substitute for a large fraction of voice traffic on wireline networks.[83] A large and growing fraction of this traffic originates and/or terminates

[81] *FCC June 2006 Local Competition Report* at Tables 2 & 5. The Commission's data do not provide a breakdown of the technology used to serve these mass-market lines, but for CLEC mass-market and enterprise lines combined, approximately 36 percent are provided via CLECs' own loops, 42 percent are provided via UNEs, and 22 percent are provided via resale. *Id.* at Table 3.

[82] *Omaha Forbearance Order* ¶ 67 (where there are "very high levels of retail competition that do not rely on [the ILEC's] facilities – and for which [the ILEC] receives little to no revenue" the ILEC has "the incentive to make attractive wholesale offerings available so that it will derive more revenue indirectly from retail customers who choose a retail provider other than [the ILEC]."); *id.* ¶ 71 (retail competition "minimizes the risk of . . . anticompetitive conduct").

[83] *See* D. Schoolar, In-Stat/MDR, *State of the US Carrier Market* at 6 (Oct. 2003) ("Consumers are using e-mail and instant messaging in place of a phone call."); C. Golvin, *et al.*, Forrester, *Sizing U.S. Consumer Telecom* at 19 n.5 (Jan. 2002) ("[a]lternate forms of communications, such as email and instant messaging, [] reduce long-distance minutes of use.").

on competitive networks, but even when carried over the incumbents' network, such traffic often substitutes for local or long distance telephone calls and displaces significant usage-sensitive (*e.g.*, per-minute or per-call) revenues that incumbents otherwise would receive. A 2006 Yankee Group survey found that "a significant portion of Yahoo! IM users stated that IM usage has replaced at least 10% of their telephony calling."[84] The three largest instant messaging providers – AOL, MSN, and Yahoo! – serve 46.4 million, 27.6 million, and 24 million active users, respectively.[85] According to the most recent J.D. Power and Associates survey of online use, approximately 36 percent of U.S. Internet users now use instant messaging on a daily basis.[86] The use of e-mail and IM in place of telephone calls also is occurring on wireless networks, where it displaces not only wireless but also wireline calls. In the case of Verizon Wireless, for example, customers sent and received 5 billion text messages on their mobile phones in September 2006 alone – up from 2 billion in September 2005.[87] CTIA reports that U.S. wireless subscribers sent 93.8 billion messages in the second half of 2006 – a 93 percent increase over the

[84] J. Simpson, Yankee Group, *Web Voice Services Challenge the Incumbents in Telecommunications* at 9 (Aug. 2006).

[85] *See* B. Nielsen, *AOL Upgrades Instant Messenger with Video*, Chicago Sun-Times (Nov. 16, 2006) (citing October 2006 data provided by Leilani Han of Nielsen//NetRatings).

[86] J.D. Power and Associates Press Release, *J.D. Power and Associates Reports: Yahoo! Messenger Ranks Highest in Customer Satisfaction among Instant Messaging Services* (Oct. 11, 2006). J.D. Power and Associates estimates that 78 percent of U.S. households subscribe to an ISP. J.D. Power and Associates Press Release, *J.D. Power and Associates Reports: High-Speed Internet Overtakes Dial-Up in Market Share as Bundling Makes Services More Affordable* (Sept. 20, 2006) (citing the J.D. Power and Associates 2006 Internet Service Provider (ISP) Residential Customer Satisfaction Survey).

[87] *VZ – Verizon at UBS 34th Annual Global Media Conference*, Thomson StreetEvents, Conference Call Transcript (Dec. 6, 2006) (statement by Verizon Chief Financial Officer Doreen Toben).

48 billion messages sent in the second half of 2005.[88] Among all major wireless carriers, data services are growing rapidly and now account for between 12-16 percent of total revenues, up by an average of 36 percent from the previous year.[89]

*Second,* as the Commission has recognized, there are a number of emerging broadband technologies, such as WiMAX, WiFi, and Broadband over Powerline, that will offer an alternative means through which mass-market customers can obtain VoIP service.[90] Because many of these alternatives are less expensive to deploy than traditional alternatives, they are being deployed in rural and other high-cost areas.[91]

*Fixed Wireless/WiMAX*. Fixed wireless service is a broadband alternative for many customers today and is likely to reach many more customers over the next few years. Currently, there are thousands of wireless Internet service providers ("WISPs") that use fixed wireless technology, often to serve rural areas that cable and DSL do not reach.[92] In Virginia, for

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[88] CTIA, *Wireless Quick Facts: December 2006*, http://www.ctia.org/media/industry_info/index.cfm/AID/10323.

[89] S. Flannery, *et al.*, Morgan Stanley, *Telecom Services: 1Q07 Preview: Bullish Expectations Should Be (Largely) Met* at Exhibit 34 (Apr. 23, 2007).

[90] *See, e.g., Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶ 33 (2005) ("*Wireline Broadband Order*").

[91] For example, Virginia Broadband provides fixed wireless services in three rural service territories and is expanding its service territory to 16 counties through a partnership with the Rappahannock Electric Cooperative. *See* Virginia Broadband, LLC, *What Is Our Coverage Area*, http://www.vabb.com/coverage.htm (as of 2005); M. Cotter, *REC Plans To Roll Out Broadband Service*, Fredericksburg.com (May 20, 2006), http://fredericksburg.com/News/FLS/2006/052006/05202006/192464/printer_friendly.

[92] *See* Wireless Broadband Access Task Force, FCC, *Connected & On the Go: Broadband Goes Wireless*, GN Docket No. 04-163 at 32 (Feb. 2005) (reporting estimates that there are between 4,000 and 8,000 WISPs). There is at least one fixed wireless broadband provider in all but three states (Connecticut, Delaware, and Rhode Island) and an average of more than 8

example, a Verizon survey revealed that fixed wireless services were available to 71 percent of households in Verizon's local telephone service area in the state. *See* Exhibit 9. WISP services also are being deployed in major metropolitan areas and small, rural communities by companies such as TowerStream and Clearwire.[93] Sprint has announced that by 2008 it will have constructed a nationwide WiMAX network to provide 2-4 Mbps service to an estimated 100 million customers, with an investment of $3 billion.[94] WiMAX services are capable of and are being used to provide voice services that compete with distance-insensitive wireline offerings.[95]

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providers in the remaining 47 states. Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *High-Speed Services for Internet Access: Status as of June 30, 2006* at Table 8 (Jan. 2007) ("*FCC June 2006 High-Speed Internet Access Report*"). WiMAX is being rapidly deployed, and more than 150 deployments were in use as of May 2006. *See* U.S. Gov't Accountability Office, *Broadband Deployment Is Extensive Throughout the United States, But It Is Difficult To Assess the Extent of Deployment Gaps in Rural Areas*, GAO-06-426 at 60 (May 2006) ("*May 2006 GAO Report*").

[93] TowerStream, *Service Areas*, http://www.towerstream.com/content.asp?serviceareas (TowerStream offers high-speed Internet access in Boston, New York City, Seattle, San Francisco, Los Angeles, Chicago, and Providence/Newport/Westerly, Rhode Island); Clearwire Press Release, *Clearwire Reports Record First Quarter 2007 Results* (May 8, 2007) (Clearwire offers service "in 38 U.S. markets, covering approximately 9.1 million people in more than 400 municipalities in Alaska, California, Florida, Hawaii, Idaho, Minnesota, Nevada, North Carolina, Oregon, Texas, Washington and Wisconsin," and serves approximately 258,000 subscribers in the U.S. and Europe). *See also* Clearwire Corp., Amendment No. 5 to Form S-1 at 1 (SEC filed Mar. 7, 2007) ("Our markets range from major metropolitan areas to small, rural communities, and all sizes in between").

[94] A. Sharma, *et al.*, *Sprint To Spend Up to $3 Billion To Build Network Using Wimax – New Wireless-System Plan Shows Belief in Demand for Mobile Internet Services*, Wall St. J. at B2 (Aug. 9, 2006); A. Mohammed, *Sprint Nextel To Build $2.5 Billion Wireless Network*, Wash. Post at D04 (Aug. 9, 2006); J. Markoff, *et al.*, *Sprint Will Build an Intel-Backed Network*, N.Y. Times at 7 (Aug. 9, 2006).

[95] *See, e.g.*, Clearwire, *Clearwire Internet Phone Service: Features*, http://www.clearwire.com/internet-phone-service/features.php; Clearwire, *Products: Internet Phone Service*, http://www.clearwire.com/internet-phone-service/compare.php (Clearwire offers unlimited local and long distance calling, along with many basic features (including voice mail, caller ID, call forwarding, 3-way calling, call blocking, etc.), for $29.99); Virginia Broadband, *What is VoIP*, http://www.vabb.com/voip.htm (Virginia Broadband advertises "Local and

In-Stat estimates that, by 2009, 8.5 million users will get their broadband services via WiMAX, with more than half of those customers receiving voice service via their WiMAX connection.[96]

*WiFi*. Initial deployment of commercial WiFi service in the U.S. involved the placement of hotspots in public gathering points such as airports, coffee shops, and parks.[97] Recently, dozens of cities have begun deploying WiFi networks to provide high-speed Internet access (typically up to 1 Mbps) and other services to businesses and residents.[98] These WiFi networks are capable of being used to access a wide range of VoIP services. A variety of equipment manufacturers (including LinkSys and NetGear) have begun producing handsets to be used on WiFi networks using Skype's VoIP service.[99]

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National telephone service for one flat rate. With your high-speed Internet connection you can get phone service, and not have to deal with any large, cumbersome phone company.").

[96] J. Hu, *Study: Net Phones Key to WiMax Success*, CNET News.com (Feb. 16, 2005), http://news.com.com/Study+Net+phones+key+to+WiMax+success/2100-1039_3-5579377.html.

[97] *See* JiWire, *Wi-Fi Hotspot Directory*, http://www.jiwire.com/search-hotspot-locations.htm (50,397 hotspots in the U.S. as of May 21, 2007); *see also* T-Mobile, *T-Mobile HotSpot: US Locations*, https://selfcare.hotspot.t-mobile.com/locations/viewLocationMap.do (T-Mobile offers more than 8,600 WiFi hotspots spanning all 50 states).

[98] According to one industry source, as of the end of March 2007, there were approximately 81 municipal WiFi networks in the U.S. that were providing public access, plus 38 additional networks that were being used solely for municipal purposes such as public safety. *See* MuniWireless.com, *List of US Cities and Regions* at 1, 3 (Mar. 31, 2007), http://muniwireless.com/reports/docs/March-31-2007summary.pdf.

[99] *Google and Skype Fund FON as Cisco Joins*, Computer Business Review Online (Feb. 7, 2006), http://www.cbronline.com/article_feature.asp?guid=2A93B2D6-BE8B-4EB8-99CD-EDF7DFB80C65 ("Skype has partnerships in place with hotspot aggregators such as Boingo and The Cloud, and already offers WiFi-enabled Skype handsets made by, among others, Linksys. A visit to any internet cafe in a big city will reveal countless individuals calling home over the P2P VoIP service, so if those connections can be wireless-enabled, it should only stand to gain more users.").

*Broadband over Powerline*. Chairman Martin has stated that BPL services "hold great promise for consumers."[100] BPL uses the electric distribution network as a third broadband pipe to the home. Because the wires needed for BPL are largely in place, BPL can be deployed rapidly and at relatively low cost in virtually any market.[101] BPL technology is being deployed commercially by Current Communications (a company backed by Google and other investors) in Ohio and Texas,[102] and by other providers in smaller deployments throughout the U.S.[103] Where BPL is available, it is capable of and is being used to access VoIP services. For example, Current Communications offers "local telephone service combined with unlimited long distance and your favorite calling features – all for one low monthly price."[104] Current voice service "is available without a subscription to broadband Internet service."[105]

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[100] Statement of Chairman Kevin J. Martin in WC Docket No. 06-10 (rel. Nov. 7, 2006).

[101] *See* S. Cleland, NetCompetition.org, *Why Competition Obviates Net Neutrality*, presentation for the FTC Internet Access Task Force at 6 (Sept. 26, 2006) ("99% of the cost to provide BPL is already paid for to supply electricity.").

[102] *See* Current Communications, *Overview*, http://www.currentgroup.com/about/index.html; Current Communications Press Release, *Current Communications Group Announces Strategic Investments To Catalyze Broadband over Power Line Deployments* (July 7, 2005); Current Communications Press Release, *Current Communications Announces $130 Million in Investments in Broadband over Power Line Networks* (May 4, 2006).

[103] *See, e.g.*, utility.net Press Release, *utility.net Announces Commercial Broadband Rollout in Michigan with Potential To Reach One Million Customers in Coming Years* (Apr. 30, 2007); United Power Line Council, *BPL Deployment Map*, http://uplc.utc.org/file_depot/0-10000000/0-10000/7966/conman/BPL+Deployment+Map+2007.pdf; BPL Co-op, *Broadband over Powerline*, http://www.forcvec.com/bplcoop/index.html (In southwestern Virginia, a joint venture of the Central Virginia Electric Co-operative and International Broadband Electric Communications is deploying BPL service to rural customers.).

[104] Current Communications, *Residential Voice*, http://www.current.net/ServiceAndPricing/Residential/Voice/.

[105] Current Communications, *Residential Voice FAQ*, http://www.current.net/ServiceAndPricing/Residential/Voice/Faq/.

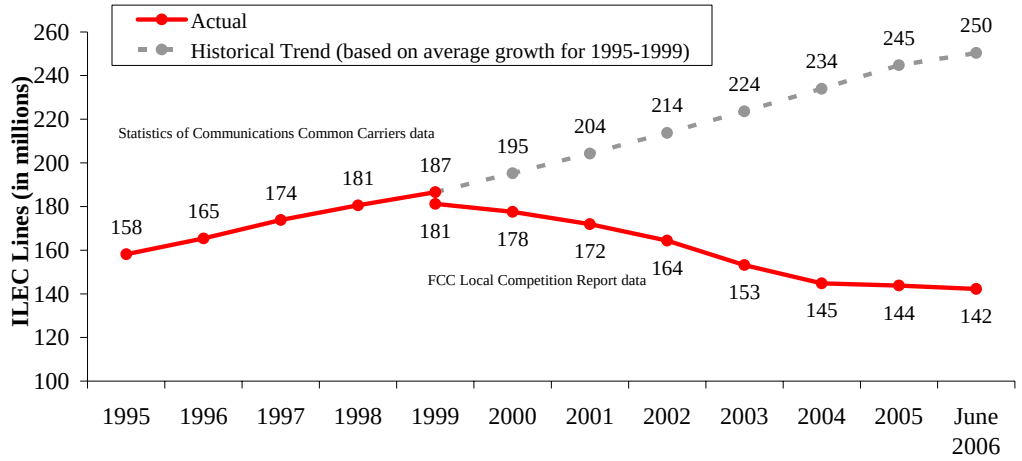
### 6. Wireline Minutes and Lines Have Declined

While competition from the various alternatives described above has been steadily increasing, the traditional wireline business has declined. Both access lines and access minutes are steadily decreasing. The migration of traffic is particularly significant for purposes of this proceeding because lost long distance traffic historically would have traversed the local network. Today, increasing amounts of long distance traffic originate, terminate, or both on alternative networks – such as wireless-to-wireless calls, and calls that originate on cable networks or other competitive last-mile facilities. Thus, while these alternatives also compete for voice services generally, it is beyond serious dispute that they can be and are used as alternatives for the long distance component of voice telephone service.

As an initial matter, any analysis of the decline in access lines and minutes must take into account not only the trend in the absolute number of lines and minutes, but also a comparison to historical growth rates. Historically, both the number of access lines and the number of minutes traversing local networks grew at a relatively stable rate, driven in large measure by growth in the population and the overall economy. But while these overall trends have continued, the numbers of local wireline lines and minutes not only are no longer growing but have actually declined in absolute terms as intermodal competition and technology substitution have increased. With respect to lines, Figure 5 shows the number of nationwide ILEC access lines over the past decade. It also compares the decline in access lines that has occurred over the past six years to the historical trend of year-over-year growth in access lines, driven by the general growth in population and the economy. Given that these larger economic trends have continued, it is apparent that the actual loss of access lines to other alternatives is even greater than what the absolute loss in ILEC lines shows, as ILECs are not capturing all of the new demand. Moreover, these trends show that ILECs are losing lines not just to cable and other wireline competitors, but

also to wireless, as the difference between the historical trend and the current number of lines exceeds the number of competitive lines that cable companies and CLECs report serving.[106]

**Figure 5. Decrease in Wireline Access Lines**




The FCC began collecting Form 477 data for the Local Competition Report for 1999, which is why the Statistics of Communications Common Carriers (SOCCC) is used for data before this point. We rely on the Local Competition Report for data after this point because, unlike the SOCCC, it consistently treats wholesale lines as non-ILEC lines. For 1999, we have provided data from both sources to illustrate the magnitude of the difference between the two sources.

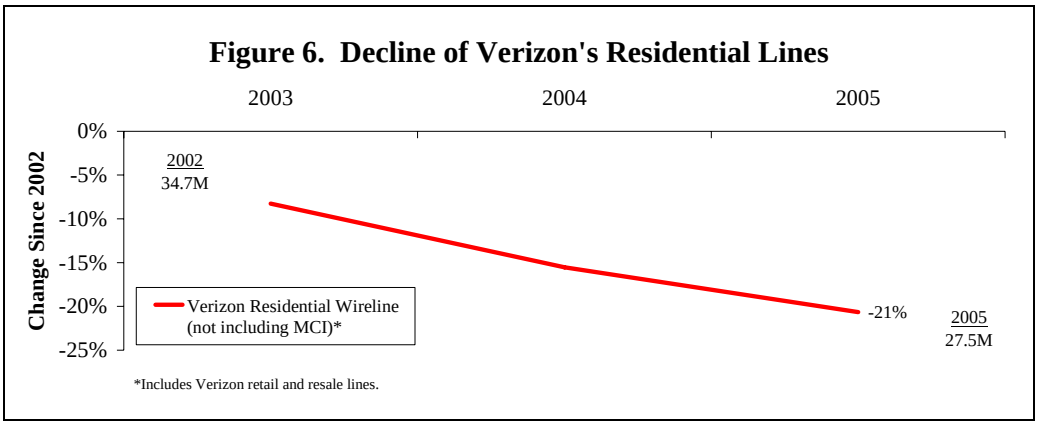
*Sources:* Ind. Anal. & Tech. Div., WCB, FCC, *Trends in Telephone Service* at Table 7.1 (2007) (citing adjusted Statistics of Communications Common Carriers data); Ind. Anal. & Tech. Div., WCB, FCC, *Local Telephone Competition: Status As of June 30, 2006* at Table 1 (Jan. 2007).

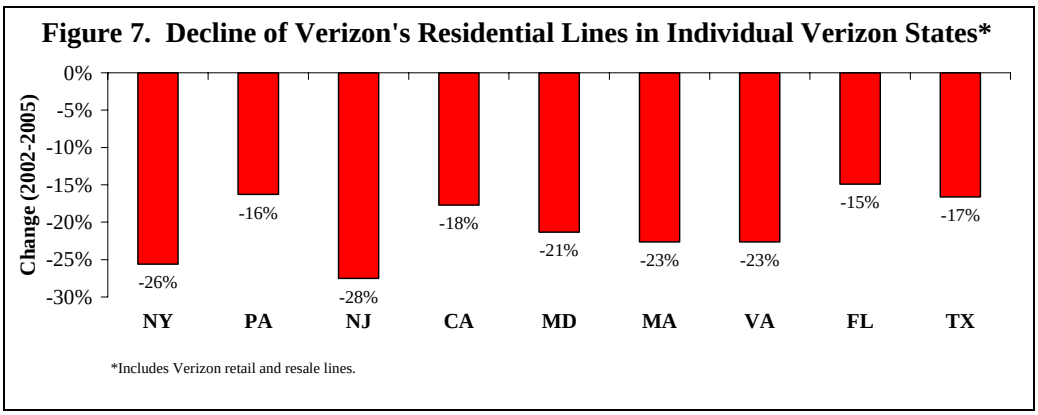
Data from Verizon provide further evidence of these trends. From 2002 through 2005, Verizon's switched access lines provided to residential customers declined by approximately 21 percent in absolute terms (from 34.7 million to 27.5 million), in contrast to the historical trend of year-over-year growth. *See* Figure 6.[107] This decline occurred both region-wide and in

[106] The loss of second lines to DSL or other competitive alternatives accounts for no more than a small percentage of the total decrease in ILEC lines. According to the Commission's most recent data, there were 26.2 million non-primary residential lines in 2000 compared to 12.1 million in 2005, representing a net loss of 14.1 million lines. *See* Ind. Anal. & Tech. Div., WCB, FCC, *Trends in Telephone Service* at Table 7.4 (2007). By comparison, Figure 5 shows a difference of 54 million lines from 2000 to 2003, and a difference of 37 million additional lines between 2003 and June 2006.

[107] During this same period (2002-2005), the number of second lines that Verizon provided declined from 5.3 million to 3.1 million, a decrease of 2.2 million. Thus, the loss of second lines to DSL or other competitive alternatives accounts for no more than a small percentage of the decrease in the Verizon's total access lines.

individual states. *See* Figure 7. And the trend has continued since the elimination of the UNE platform ("UNE-P"). Verizon had, as of December 2004, lost approximately 4.4 million residential lines to UNE-P, and since the abolition of the UNE-P Verizon's access lines have continued to decline in both absolute and relative terms. As one analyst has explained, "the telcos failed to win back a substantial portion of wholesale line cancellations, which customers likely took one of three paths: (1) they shifted to wireless only, (2) they defected to standalone, price-competitive VoIP providers, or (3) they opted into cable triple-play bundles. The probable answer is a little of all three occurred, with the emphasis on the latter two and increasingly #3."[108]

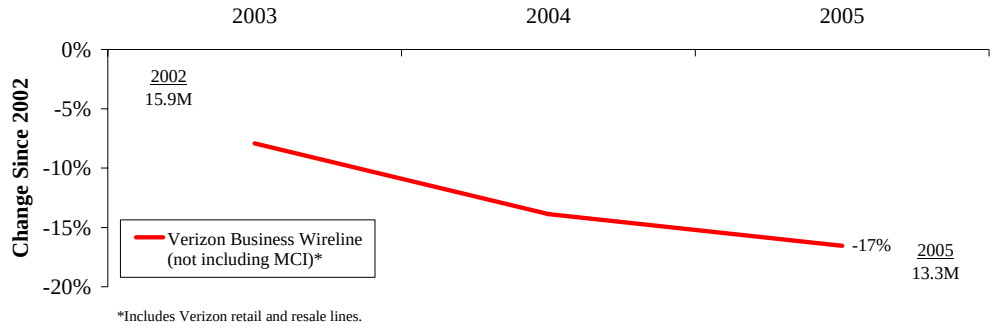



[108] C. Moffett, *et al.*, Bernstein Research, *Quarterly VoIP Monitor: Six Million and Counting* at 10 (June 12, 2006).

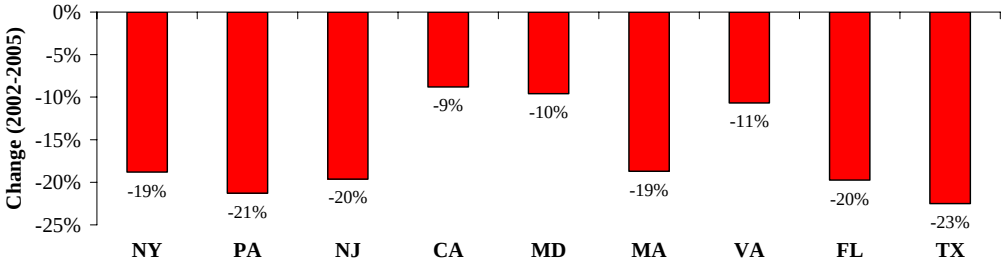
Verizon's data also show a decline in switched access lines provided to business customers, which includes very small businesses that the Commission considers part of the mass-market, as well as medium and large enterprise customers. From 2002 through 2005, Verizon's switched access lines provided to business customers have declined by approximately 16 percent (from 16.8 million to 14.1 million). *See* Figure 8. This decline occurred both region-wide and in individual states. *See* Figure 9.

**Figure 8. Decline of Verizon's Business Lines**




*Includes Verizon retail and resale lines.

**Figure 9. Decline of Verizon's Business Lines in Individual Verizon States***

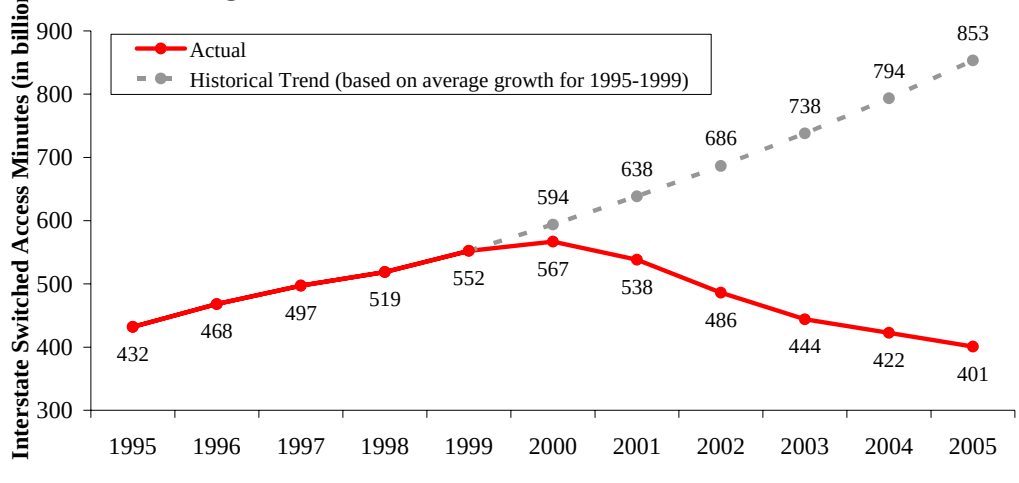



*Includes Verizon retail and resale lines.

With respect to minutes, Figure 10 shows the number of interstate switched access minutes from 1995 to 2005 (the most recent year the Commission reports). It also compares the decline in minutes that has occurred over the past five years to the historical trend of year-over-year growth in interstate switched access minutes access lines, driven by the general growth in population and the economy. As noted above, given that these larger economic trends have

continued, it is apparent that the actual loss of minutes to other alternatives is even greater than what the absolute loss in interstate switched access minutes shows, as ILECs are not capturing all of the new demand.

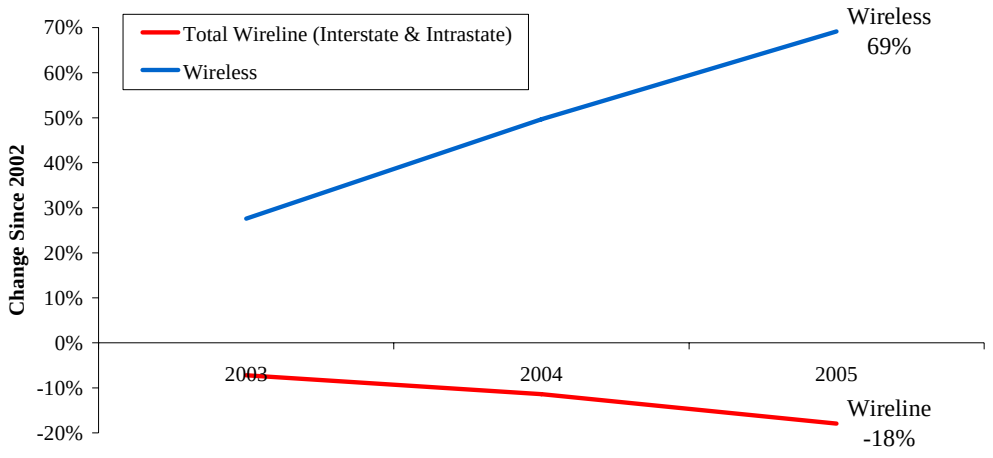
**Figure 10. Decrease in Wireline Access Minutes**




*Source:* Ind. Anal. & Tech. Div., WCB, FCC, *Trends in Telephone Service* at Table 10.1 (2007).

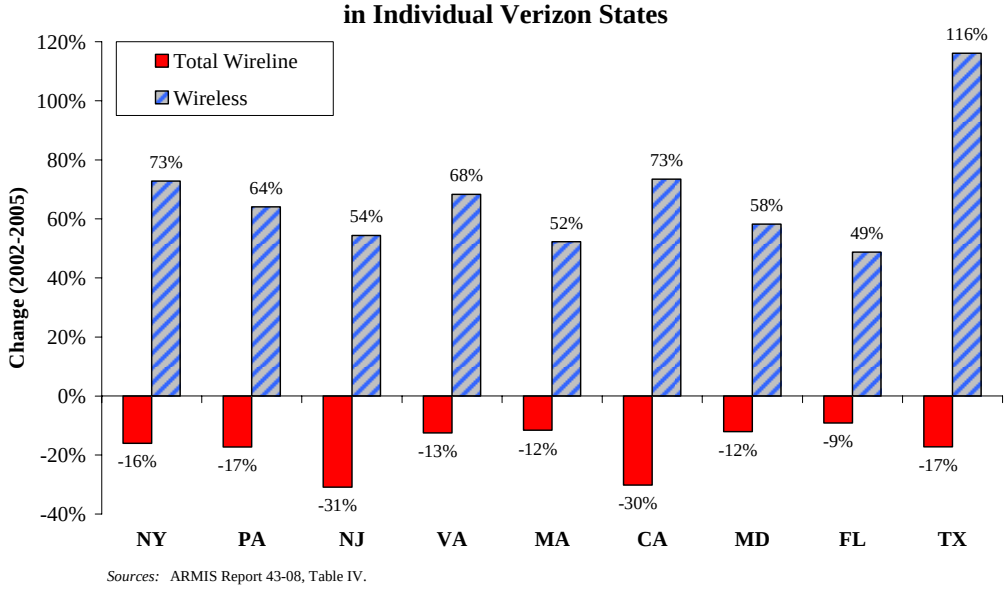
Here, too, Verizon's data provide further evidence of these trends. Between 2002 and 2005, the number of billed access minutes originating or terminating on Verizon's wireline network billed to interexchange carriers decreased by 18 percent. *See* Figure 11. By contrast, minutes that Verizon terminated for wireless carriers during this period increased by 69 percent. *See id.* Actual use of wireless is, of course, much greater as this does not include the significant amount of wireless-to-wireless traffic that takes place, or the calls between wireless and other competitive wireline or cable networks. Figure 12 shows that, just as these trends are taking place across Verizon's local telephone service areas, they also are occurring within individual states.

**Figure 11. Verizon's Wireline Billed Access Minutes Have Steadily Declined While Minutes Terminated for Wireless Providers Have Increased**




*Sources:* ARMIS Report 43-08, Table IV.

**Figure 12. Verizon's Wireline Billed Access Minutes Have Steadily Declined in Individual Verizon States**

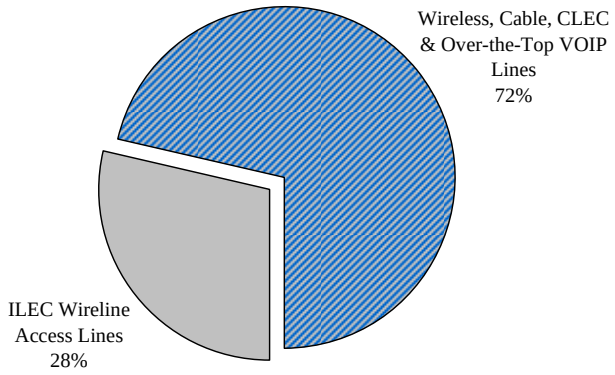



*Sources:* ARMIS Report 43-08, Table IV.

Finally, while static market shares are not meaningful given the rapid emergence of new competitors and the trajectory of competition, an analysis that includes even just the principal alternative providers of voice service makes it clear that Verizon and other carriers do not have anything approaching a dominant position, and certainly do not have a position that would allow them to dominate in the long distance component of voice services. As of June 2006, ILEC wireline access lines accounted for only approximately 28 percent of all voice connections

provided to mass-market consumers, with cable, wireless, over-the-top VoIP, and other CLECs accounting for the rest.[109] *See* Figure 13. As explained above, including all of these alternatives is particularly appropriate in this proceeding, because consumers are extensively using all of these competitive options to make long distance calls. As also noted above, this figure is conservative, because in the second half of 2006 the use of these various alternatives continued to grow, while ILEC lines continued to decline.

**Figure 13. ILEC Wireline Access Lines Constitute a Small Share of Voice Connections**




Data as of June 2006.
*Sources:* Ind. Anal. & Tech. Div., WCB, FCC, *Local Telephone Competition: Status as of June 30, 2006* at Tables 2 & 14 (Jan. 2007); C. Moffett, *et al.*, Bernstein Research, *Quarterly VoIP Monitor: Playing Follow the Leader (…Cablevision, That Is)* at Exhibit 17 (Sept. 20, 2006).

[109] This estimate was calculated as follows. The denominator is the sum of (1) ILEC and CLEC residential wireline access lines, (2) the number of wireless subscribers, and (3) the number of over-the-top VoIP subscribers. The number of ILEC and CLEC lines, and the number of wireless subscribers are based on the FCC's *June 2006 Local Competition Report* (Tables 2 and 14, respectively). Estimates of over-the-top VoIP subscribers are based on the 2Q06 estimate by Bernstein Research. C. Moffett, *et al.*, Bernstein Research, *Quarterly VoIP Monitor: Playing Follow the Leader (. . . Cablevision, That Is)* at Exhibit 17 (Sept. 20, 2006). As this analysis compares ILEC wireline access lines to competitive alternatives, it does not attribute the wireless subscribers of any ILEC wireless affiliate to the ILEC. This approach also is appropriate given that wireless is robustly competitive with ILEC wireless affiliates competing against unaffiliated wireless providers nationwide. In order to remain competitive for wireless services, ILEC wireless affiliates must provide service offerings comparable to those of their rivals, even where such offerings compete against the affiliated ILEC's wireline service.

### B. Enterprise

The Commission has found that retail competition for enterprise customers is "strong" and will remain so "because medium and large enterprise customers are sophisticated, high-volume purchasers of communications services that demand high-capacity communications services, and because there [are] a significant number of carriers competing in the market."[110] The Commission recognized that "interexchange carriers, competitive LECs, cable companies, other incumbent LECs, systems integrators, and equipment vendors" all "are prepared to make competitive offers" to enterprise customers and that they therefore "ensure that there is sufficient competition."[111] A number of states have reached similar conclusions.[112] These findings apply

[110] *Verizon/MCI Order* ¶ 56.

[111] *Id.* ¶ 74.

[112] *Joint Petition of Verizon Communications Inc. and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction Over or in the Alternative for Approval of Agreement and Plan of Merger*, Order Asserting Jurisdiction and Approving Merger Subject to Conditions, Case 05-C-0237 at 33-34 (N.Y.P.S.C. Nov. 22, 2005) ("We agree with Staff that a direct, retail-based remedy is not required for the Enterprise market. As a group, Enterprise customers are sophisticated purchasers of telecommunication services. These large customers can obtain services from alternative providers or negotiate a competitive price for service if they are not satisfied with either price or service from their current provider."); Draft Report on the Status of Competition in the Telecommunications Industry, Division of Competitive Markets and Enforcement at 4 (*72) (Fla. P.S.C. May 31, 2006) ("[E]vidence suggests that these intermodal competitors are successfully providing competitive alternatives to both residential and business subscribers. . . . [T]he Commission concludes that competitors are providing functionally equivalent service to both residential and business customers."); *California Regulatory Reform Order* at 3-4, 75, and 164 ("In conclusion, there is no evidence concerning the basic business segment of the voice communications market that causes us to reassess the conclusions reached in our general market analysis. Indeed, the evidence that we have supports our two major conclusions – that there is a single market for voice communications and this market is subject to significant competition by different technologies. Consequently, we find that it is reasonable to eliminate all price regulations of basic business service effective immediately."); *id.* ("wireless competition plays a particularly important role in the basic business segment of the voice communications marketplace" and provides evidence of "significant cross-platform competition among providers of basic business service.").

with equal force in this proceeding, where the ultimate question likewise concerns competition at the retail level.[113]

As the Commission has recognized, enterprise customers tend to purchase packages of service that include not just distance-insensitive voice services, but also myriad data services as well as network integration and management capabilities and wireless services.[114] Indeed, large enterprise and other commercial and institutional customers now spend more on data and wireless than they spend on wireline voice, and data and wireless spending is growing considerably, while wireline voice spending is declining.[115] Any reasonable competitive analysis should therefore analyze the full array of services that large enterprise customers and medium businesses purchase as a whole, rather than partition those packages into artificial categories that are no longer relevant in the marketplace.

Verizon's share of retail business services revenues as a whole is relatively small. In an October 2006 report, Lehman Brothers estimated Verizon's 2006 business services revenues at $19.7 billion, compared to $103.7 billion for the market as a whole, representing a share of approximately 19 percent.[116] These totals appear to include all business customers, and may include some customers that the Commission has traditionally counted as part of the mass

[113] *See Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914, ¶ 22 (2003) (noting that Commission's focus is ability of carrier "to unilaterally raise and sustain" retail prices in the relevant markets).

[114] *Verizon/MCI Order* ¶ 57.

[115] *See* T. Seitz, Lehman Brothers, *Telecom Services – Wireline* at 4, Figure 5 (Oct. 18, 2006).

[116] *Id.* at 14, Figure 19.

market. Lehman Brothers' most recent report does not provide a revenue breakdown for different classes of business customers.

Verizon's share of retail data services revenues provided to business customers also is small. Lehman Brothers estimated Verizon's share of such revenues at 14.5 percent in 2006, and expected it to decline to 13.9 percent in 2007.[117] This is significant for several reasons. *First*, the retail data services analyzed in the Lehman report are the types most often purchased by medium and larger businesses,[118] which confirms that Verizon faces intense competition for these customers in general. *Second*, enterprise customers are increasingly using data services to carry their voice traffic. As a result, the intense competition that Verizon faces in the provision of retail data services also disciplines the retail voice services that are at issue here.

Verizon faces competition from traditional telecom carriers such as AT&T, Level 3, Sprint, Global Crossing, Broadwing, XO, and One Communications; managed service providers and systems integrators such IBM, Electronic Data Systems Corp., Accenture, Northrop Grumman, and Lockheed Martin; and equipment vendors such as Lucent and Nortel. Exhibit 10 summarizes the voice services that traditional competitors are offering in Verizon's local telephone service areas; Exhibit 12 provides further descriptions of these offerings from the competitive providers' own websites. Moreover, to the extent medium or large business customers use basic switched business lines, they have all the same alternatives as mass-market customers, and, as shown above (*see* Figures 8 & 9, *supra*), are using these alternatives given the declines in retail business lines.

[117] *Id.* at 11, Figure 15.

[118] Lehman includes the following services: "Unmanaged Business Data Transport, Legacy Packet, IP (Direct Internet Access), Fiber/Ethernet, Other High Speed, Managed Data Networks, Data Centers/Hosting/Content Delivery). *See id.*

Cable operators are also moving aggressively into the enterprise market, and are competing for medium-sized businesses as well as smaller businesses that the Commission has defined as part of the mass market. Each of the major cable companies in Verizon's local telephone service areas – Time Warner, Cablevision, Cox, and Comcast – has been offering data services to enterprise customers for many years, and most are now expanding to provide voice services. *See* Exhibit 11 (describing cable voice offerings). One analyst estimates that the cable industry will "grow its commercial revenue base from $1.3B this year to $2.0B in '07 and $3.2B by '08."[119] Buckingham estimates that cable operators have already won approximately 4 percent of revenues for small and medium enterprise customers, and that cable companies can use their existing plant to target more than 85 percent of commercial revenues.[120]

By way of examples, Cablevision offers "Optimum Voice for Business," which provides "local, regional and long distance calling . . . for one low, fixed per-line monthly rate; a rate that could save you as much as 60 percent per month, or more."[121] Cablevision's COO Tom Rutledge told company investors in March 2007 that "we think there is a significant opportunity to take share out of the small business marketplace and the large business marketplace," which he estimates at "a $6 billion spend right now by small businesses and large businesses inside our footprint for telecom."[122] Cablevision has "identified over 600,000 businesses inside our

[119] Q. Hasan, *et al.*, Buckingham Research Group, *Cable Goes Commercial: Examining Cable's Next Growth Phase* at 18 (Jan. 11, 2007).

[120] *Id.* at Exhibit 14.

[121] Cablevision, *Optimum Voice for Business, Advantages*, http://www.optimum.com/business/ov/advantages.jsp.

[122] Thomson Street Events, *CVC – Cablevision Systems Corp. at Banc of America Media, Telecommunications & Entertainment Conference*, Transcript at 2 (Mar. 28, 2007) ("Cablevision/Rutledge MTE Conf. Tr.").

footprint that we passed with cable that were serviceable today," using Cablevision's *existing* plant that was originally deployed to serve residential customers.[123] Cablevision accordingly "began marketing those buildings last year, and we are now in the middle of earnestly marketing the 600,000 business marketplace."[124] Mr. Rutledge has said that Cablevision has "more fiber in the [New York/New Jersey/Connecticut] tri-state area" "than any phone company,"[125] and that Cablevision already has fiber service to twice as many buildings in its metropolitan New York footprint as Verizon does.[126] The company has developed "a full suite of high-end and middle and low market products in IP form to go into those markets and compete against the incumbent phone operator with superior products, superior service and a superior reputation in that marketplace."[127] The company has "developed an inbound sales force" as well as an "outbound sales force" and a "door-to-door sales force" to serve business customers, as well as a "separate service call facility to handle customer questions and staffed it 24 hours a day that we can provide the highest quality service."[128] The company claims that it will "charge about half of

[123] *Id.* at 7. Cablevision determined this by "build[ing] a database" by "collect[ing] various business databases and we physically walked out our plant and identified all the small businesses inside our footprint and cross-referenced them against all the various databases." *Id.* Through this process, Cablevision determined that its existing cable plant could be used to serve 600,000 businesses because its "physical assets on the poles or in the conduits were in front of that building and all we needed to do was put in an installation drop to create connectivity to that building." *Id.*

[124] *Id.*

[125] S. Moritz, *Cablevision's Got Fiber*, TheStreet.com (Sept. 20, 2006) (internal quotation marks omitted), http://www.thestreet.com/newsanalysis/techtelecom/10310196.html.

[126] *See* M. Farrell, *Cablevision Revs Up for Business Blitz*, Multichannel News (Sept. 25, 2006), http://www.multichannel.com/article/CA6374465.html.

[127] Cablevision/Rutledge MTE Conf. Tr. at 2.

[128] *Id.* at 7.

what Verizon or AT&T charges for the same service with a higher-quality service and a more sophisticated service, too, because it is all IP. And in terms of data capacity, in terms of voice quality, it is equal to or better than anything the incumbents provide and build for the future."[129]

Cox Business Services offers a variety of voice services to enterprise customers, including digital telephone, Centrex, digital trunks, and dedicated long distance.[130] According to Cox, with Cox Business Services, "your business can enjoy the savings and convenience of getting your local and long distance service from one company, with one bill and one point of contact."[131] In October 2006, Cox Business Services claimed that its revenue is currently growing at 20 percent per year and that "the RBOCs certainly know we're . . . taking business from them."[132] In May 2007, Cox announced that "Cox's early vision and commitment to telephony is also bringing significant returns to the company via its delivery of commercial telecom services to small- to medium-sized businesses. Cox ended the [first quarter of 2007] with more than 187,000 commercial customers, reflecting 32.2% year-over-year growth."[133]

Comcast's CEO has stated that commercial services represent the "next great business opportunity" for Comcast, and that it will do the "same thing" in the enterprise market as it has

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[129] *Id.*

[130] Cox Business Services, *Cox Digital Telephone and Voice Mail*, http://www.coxbusiness.com/products/voice/digitaltelephone.html.

[131] *Id.*

[132] J. Duffy, *Cable Companies Intensify Enterprise Service Ambitions*, Network World (Oct. 24, 2006) (quoting Hyman Sukiennik, Vice President and General Manager, Cox Business Services).

[133] Cox News Release, *Cox Answers the Phone and Says "Hello" to Continued Growth* (May 1, 2007).

done in the mass market.[134] Comcast has told investors that it would be making a "$250 million investment in commercial services in 2007."[135] In May 2007, Comcast stated that "[i]n our footprint, we believe there's north of 6 million customers that have fewer than 500 employees and these customers spend as much as $18 billion annually on telecom services."[136] The "sweet spot" within this segment, according to Comcast, is "the small end of the SMB, and those are the customers that are fewer than 20 employees. . . . with an annual spend in the 12 to $15 billion range."[137]

Time Warner Cable has announced that, "[i]n 2007, we will launch Time Warner Cable's Business Class Phone, an offering directed towards small to medium sized businesses."[138]

Many enterprise customers also are using VoIP technology in place of traditional switched services. Enterprise customers were the first to adopt this new technology. They have migrated their traditional voice services to IP Virtual Private Network ("VPN") and other converged services that are provided over Multi-Protocol Label Switching ("MPLS")

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[134] *See Comcast Corporation at Citigroup 17th Annual Entertainment, Media and Telecommunications Conference – Final*, FD (Fair Disclosure) Wire, Transcript 010907aw.757 (Jan. 9, 2007) (statement by Comcast chairman and CEO Brian Roberts).

[135] Thomson StreetEvents, *CMCSA – Q4 2006 Comcast Corporation Earnings Conference Call*, Conference Call Transcript at 6 (Feb. 1, 2007) (statement of Comcast Corp. EVP, Co-CFO and Treasurer, John Alchin).

[136] *Comcast Investor Day A.M. Session – Final*, FD (Fair Disclosure) Wire, Transcript 050107ai.739 (May 1, 2007) (statement by Comcast Business Services President Bill Stemper).

[137] *Id.*

[138] Thomson StreetEvents, *TWX – Q4 2006 Time Warner Inc. Earnings Conference Call*, Conference Call Transcript at 4 (Jan. 31, 2007) (statement of Time Warner Inc. Chairman & CEO, Dick Parsons).

networks.[139] These converged services are being used in place of all local, interexchange, and international voice and data services. A study by In-Stat predicts that business IP phone shipments will increase approximately 450 percent between 2006 and 2010 (from 10 million to more than 45 million).[140] Another heralded development in the enterprise market is the addition of VoIP capabilities to the new Microsoft Vista Office suite. Microsoft's Chairman, Steve Ballmer, has stated that "[w]e are going to enter the voice over IP market the beginning of [2007]."[141] Analysts have called the new service "a push into the enterprise voice market, bringing the software powerhouse right to the Bells' back door."[142]

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[139] *See* M. McCormack, *et al.*, Bear Stearns, *U.S Wireline Services: The Catalyst for Consolidation* at 53 (June 2005) ("We expect significant interest in VoIP as businesses pursue the convergence of their voice and data networks onto a single platform in order to improve efficiency, reduce costs, and develop new revenue-generating value-added services. We note that several large companies have made VoIP deployment announcements, including Ford (50K IP phones with SBC), Bank of America (180K IP phones with Cisco and EDS), and Boeing (150K IP phones with Cisco).").

[140] P. Tufegdzic, *et al.*, In-Stat, *IP Phones Invade the Home and Office* at Figure 1 (Nov. 6, 2006).

[141] D. Gardner, *Microsoft to Launch Major VoIP Move Early Next Year*, InformationWeek (Nov. 7, 2006), http://www.informationweek.com/hardware/showArticle.jhtml?articleID=193600273; C. Mellor, *Microsoft Informer: Microsoft Vista to Get VoIP*, CIO.com (Nov. 8, 2006), http://www.cio.com/blog_view.html?CID=26481(Microsoft's new software "will group VoIP, e-mail, video-conferencing and instant messaging into a single communications facility that will be incorporated into desktop and server applications as well as the Vista OS.").

[142] J. Halpern, Bernstein, *U.S. Telecom: Internal Transformation Holds the Key to Unlocking Long-Term TelCo Values* at 2 (July 14, 2006); *see also* S. Cleland, *et al.*, Precursor Group, *"Telecom Tunnel Vision" of SBC-T and VZ-MCIP* at 1 (Mar. 10, 2005) ("MSFT's just-announced Live Communications Server (LCS) offering is a potentially game-changing edge application that threatens to dis-intermediate SBC-T and VZ-MCIP's coveted enterprise customers. MSFT's inexpensive LCS application essentially subordinates voice as sub-application of Office. Ultimately, we see MSFT and other tech companies eroding much of T's and MCIP's higher-value-added revenue. Over time, what enterprises equipped with MSFT LCS mostly will need from SBC-T and VZ-MCIP is just a fat dumb pipe.") (emphasis omitted); M. McCormack, *et al.*, Bear Stearns, *Key Takeaways from VON Conference* at 2 (Mar. 20, 2006)

Enterprise customers also are using wireless extensively. According to the Yankee Group, U.S. businesses now spend a quarter of their telecommunications budgets on wireless offerings – about $33 billion a year.[143] For the average company with more than 500 employees, Yankee Group estimates that "a full 40% of them are mobile."[144] Business customers also use wireless e-mail extensively, and much of this messaging substitutes for voice calls. As of year-end 2005, there were an estimated 6.0 million data device subscribers (Blackberries, laptop cards, and so forth), which is expected to grow to 16.4 million by the end of 2008.[145]

(Microsoft's new service "may be gaining critical mass among customers and represents a strong selling point to deploy VoIP in the enterprise.").

[143] J. Henry, *Analyzing Wireless Use Pays Off,* Arkansas Business (Apr. 24, 2006).

[144] *Yankee Group Issues Results of 2005 Wireless User Surveys; Analysis Reveals Burgeoning Trends and Provides Actionable Recommendations*, Business Wire (June 21, 2005).

[145] J. Armstrong, *et al.*, Goldman Sachs, *2006 Outlook – Stuck In Neutral* at 27 (Jan. 13, 2006).